

# Department of Treasury Position Memo

To: Treasurer Nick Khouri  
From: Osborne, Ken (TREASURY)  
CC: Greg Gursky, Howard Ryan  
Date: March 20, 2018  
Re: SB 887 S-3 Use Tax exemption for Contractors who receive property from their customer

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## Treasury Position: SB 887 S-3 Version Opposed

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**Short Summary:** The proposal would exempt tangible personal property from sales or use tax that was provided to a construction contractor that was later affixed to real property so long as the entity that provided the material was not exempt from the sales or use tax.

**Background:** Under current law use tax liability rests with the contractor that consumes tangible personal property by affixing it to real property, even if the material was not purchased by the contractor. A contractor can satisfy their obligation to pay the use tax if they can demonstrate that another party paid sales or use tax on the materials used in fulfillment of the contract. Industry has argued, and Treasury would agree, that the process for contractors to demonstrate that sales or use tax was paid by another party can be difficult to comply with. The bill seeks to alleviate that burden by creating an exemption from the tax for transactions that meet these requirements.

### Discussion of Key Principles:

**Efficiency:** The bill does not substantially impact the efficiency of the tax.

**Fairness:** Creating an exemption for tangible personal property that is exchanged in a specific type of transaction raises fairness concerns for those who structure their business differently. Currently, a contractor is ultimately liable for the tax on materials used in fulfillment of a real property construction contract, regardless of how those materials were acquired. This would create an exemption for a specific type of transaction. In the long term, anyone in the industry could utilize this construct to structure their contract to take advantage of this, so the fairness concern could be mitigated.

**Simplicity:** The bill seeks to simplify compliance with the Use Tax for contractors who receive tangible personal property from their customers without directly purchasing it from them. It may have the impact of pushing the requirement to demonstrate that tax has been paid on to their customers, most likely well after the contract has been completed.

**Diversification (Tax Base):** The bill sponsor and industry have indicated that their intention is not to create a new exemption from the tax, but to clarify that the liability rests with someone other than the contractor. If that were the case, the impact on the tax base would be zero. However, the bill as currently written is ambiguous as to whether or not the liability would

transfer to the contractor's customer to demonstrate that the tax was paid, and if not, to satisfy the liability. Given the size of the construction and installation industry, this has the potential to have a significant impact if not constructed carefully.

**Conclusion:** At this time, Department of Treasury is opposed to the proposed substitute S-3. The language creates a situation where it will be very difficult to determine whether sales or use tax has been paid on materials that end up being incorporated into real property. We remain open to working with the sponsor and stakeholders to simplify this process in a way that works for industry but allows Treasury to continue to ensure that tax that is otherwise legally owed is paid.